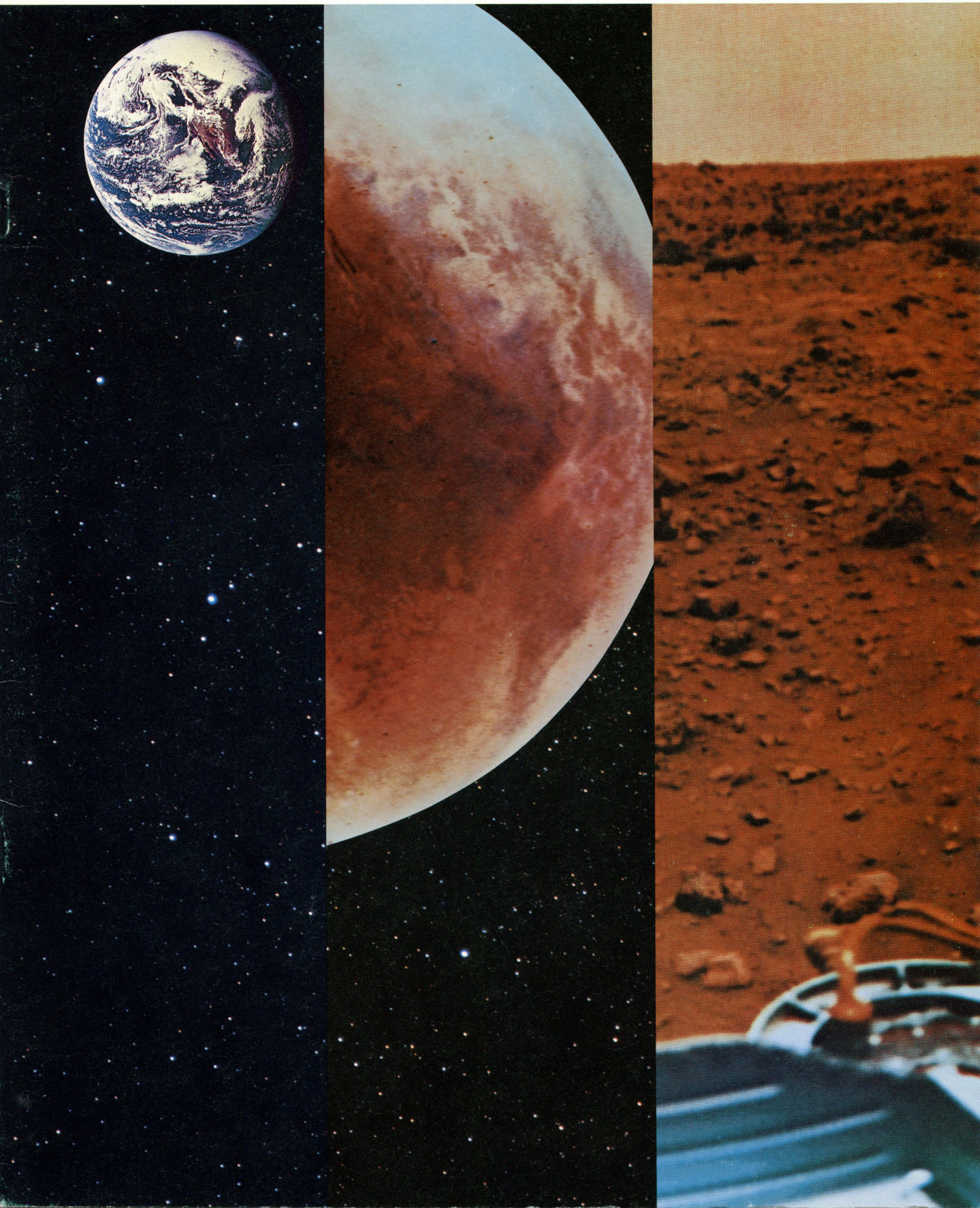
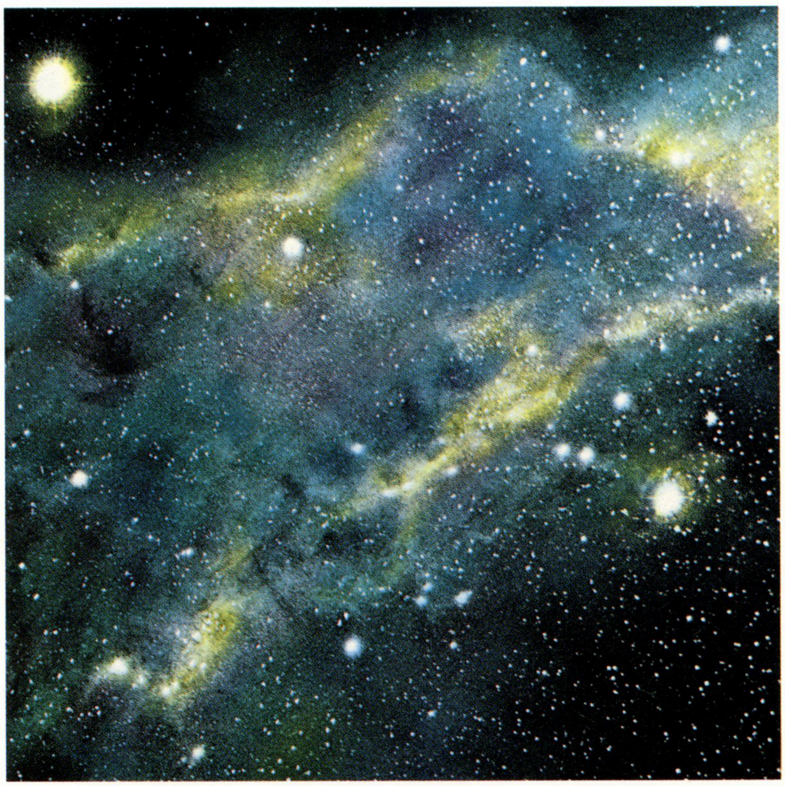
Watkins-Johnson Company Annual Report 1976





ABOUT THE COVER: *The pictures of the Martian surface were transmitted as millions of bits of radio data from the Viking Lander to Earth via a WJ-1185 Traveling-Wave Tube Amplifier (TWTA) or from the Lander to the Orbiter via VHF, then from the Orbiter to Earth via a WJ-1084 TWTA.*

Viking 1 obtained this picture of the Martian surface on July 24, 1976. Camera number 1, facing southeast, captured part of the spacecraft's gray structure in the foreground. A bright orange cable leads to one of the descent rocket engines. An orange-red material, apparently forming a thin veneer over darker bedrock, covers most of the surface. A zone of large dark boulders is present in the far field. The sky has a reddish cast, which probably is due to scattering and reflection from reddish dust suspended in the lower atmosphere. This picture has been radiometrically calibrated, using information on camera performance acquired before launch. Although the colors are very vivid, the fidelity with which the bright orange cable is reproduced suggests that the intense colors of the Martian surface are, in fact, exactly as they appear in the photograph.

Previous annual reports have identified the electronic warfare, or EW, market as being our major market. It still remains so today. However, another significant market is space communication and telemetry, both military and civilian, and we thought you would like to know something about it.

Your Company has a long and successful history of participation in a variety of space programs. W-J traveling-wave tube amplifiers, antennas, mixers and solid-state amplifiers have flown in space vehicles of state-of-the-art programs such as Mariner Mars, Pioneer, Helios, Earth Resource Technology Satellite, Viking, Apollo and numerous classified Department of Defense satellites. Products recently manufactured will fly in Fleet Satellite Communications, Maritime Satellite, Domestic Satellite, Japanese Communication Satellite, Airborne Warning and Control System and the Global Positioning Satellite. Six of the seven antennas required for the Space Shuttle Orbiter will be supplied by the Recon Division's Antenna Section. In addition, the SSE Division's Space Communications Section, in conjunction with the Tube Division, is providing the 100-watt dual S-band traveling-wave tube amplifier that will power communications between the Orbiter and Earth.

Of particular interest are the extreme requirements imposed on Watkins-Johnson's design and manufacturing processes for space components. For example, a unique specification for the Viking TWTA, not previously applicable to other programs, was that the unit be sterilized. International agreements require that all landers on other planets be sterile in order to prevent any contamination of the planet with Earth organisms. Had the Lander crashed on its attempt at landing, there was a possibility that organisms buried deep within the unit could have been strewn across the surface of Mars. To avoid the possibility of this, each instrument on the spacecraft had to be designed to withstand the rigors of sterilization: baking at extreme temperatures for extended periods of time. Another example of the special requirements applicable to space equipment is that it be tested in, and readily survive, shock environments similar to the blast that takes place when rocket stages are separated. It follows, then, that meticulous attention is paid to every element of the engineering and manufacturing process to assure standards of quality and reliability unknown in other products. For example, just with respect to soldered electrical connections, as many as four individual quality assurance stations inspect, in turn, each of hundreds of connections to assure that they are perfect.

The selection of your Company to participate in these programs is, indeed, a testimonial to the incredible performance and reliability of the components produced. Even more, it reflects the skills and talents of the dedicated W-J employees who work on these programs. Space-qualified component manufacturing is difficult and demanding, to be sure, but the challenging problems encountered not only are solved, but their solutions lead to special processes and materials that are often useful in our other product lines. It is this kind of involvement, dedication and proven creativity that is rapidly making Watkins-Johnson Company a leader in space technology.

TO OUR SHAREOWNERS:

1976 throughout much of its course was a difficult year for your Company. Sales at $71,982,133 were down 6 percent from 1975's $76,827,879; net earnings totaled $4,826,368, a 33 percent decrease from the year earlier total of $7,165,528. Earnings per share in 1976 were $1.57, on 3,082,548 average shares outstanding, compared to $2.34 per share on 3,066,710 average shares in 1975. The 1976 earnings include a nonrecurring gain of 10 cents per share from real estate transactions.

The total firm order backlog on December 31, 1976 was $76,746,000, up 80 percent from the $42,743,000 at the end of 1975. Of the 1976 backlog, 64 percent is shippable in less than 12 months. The comparable portion for the earlier backlog was 80 percent.

Shareowners' equity at 1976 year end was $48,107,342, compared to $44,210,661 at the end of 1975. Working capital at $38,779,254 increased by more than $4 million from 1975's year-end total.

Two major problems caused the downturn in the performance of your Company last year: delays in receiving orders, which led to reduced sales and earnings; and a costly production error, discovered in the third quarter, which led to an additional reduction of earnings.

There is little the Company can do about delayed orders. However, in the future we will plan on longer negotiation periods before the receipt of complex, larger orders. This should provide us with earlier and clearer indications of potential sales deficiencies. With better warning, we can take corrective measures, such as reducing costs and expanding selling efforts, sooner and in a more effective manner.

The production problem, which involved one of our most critical components, resulted from a supplier providing us with the wrong type of nickel alloy—sintered rather than cast—which, while chemically identical to the correct material, possessed different physical properties which led to early failures of the component. Our internal inspection procedures, designed to catch errors by vendors, have been modified and strengthened accordingly.

Some of the highlights of 1976 were:

1976 Acquisition of a new plant site in San Jose, California, of approximately 35 acres, on which several new buildings will be built. The first, comprising some 175,000 square feet of floor space, is scheduled for completion by January 1, 1978. (Our lease on the undeveloped plant site in Cupertino, California was sold back to the original owners and accounted for almost all of the real estate transactions gain.)

1976 Increase of the cash dividend from 5 cents per share to 8 cents per share. The Company's ninth through twelfth consecutive quarterly cash dividends were paid on March 24, June 24, September 23, and December 27.

1976 Foreign sales amounting to 23 percent of total sales, down from the 32 percent sold to foreign customers in 1975.

1976 Creation of more than 180 new products as a result of customer sponsorship and of Company investment of $4,381,000 in research and development, an amount slightly in excess of 6 percent of sales, and 10 percent greater than the $3,972,000, or 5 percent of sales, invested in 1975. Some of the new products developed were the WJ-3617, a 10-watt, high-gain, high-efficiency traveling-wave tube for use in defense satellite communications systems; the WJ-3620 EBS amplifier with 1.5 kilowatt peak RF power at a 1 percent duty factor and 25 dB gain; the WJ-3500 series of traveling-wave tubes, utilizing a new low-cost packaging concept, for commercial laboratory applications; the WJ-977 chemical vapor deposition furnace for very high volume production of coated glass products for items such as liquid crystal displays; the WJ-2880 family of low-cost, miniature thin-film voltage-controlled oscillators for ECM use; the WJ-2870 family of mechanically and electrically tuned, cavity-stabilized solid-state oscillators; the WJ-5215-3 band reject filter; the WJ-A74, A76 and A37 miniature, ultra-high-frequency amplifiers; the WJ-5320-77, 12 to 18 GHz solid-state amplifier; the WJ-8718 general-purpose, high-frequency, computer-controllable receiver; the WJ-8971 emitter direction-finding system; the WJ-9518 digitally controlled frequency-division multiplex demodulator covering 300 Hz to 15 MHz; the WJ-1440 "Memory Scan," microprocessor-controlled, 30 MHz to 40 GHz receiving system; the WJ-1270 pulse train analyzer for fine-grain, real-time analysis of complex signals; the 100-watt, S-band traveling-wave tube amplifier for the Space Shuttle; and the SN 105 local oscillator synchronizer for use in applications where space is limited and temperature extremes are likely.

During the year, our long-time friend, director Porter Sesnon, retired from the Board of Directors. We are grateful for his years of devoted service and wish him well in his future activities.

Mr. James A. Collins, Chairman and Chief Executive Officer of Collins Foods International, Inc., was elected to fill the vacancy created by Mr. Sesnon's resignation.

Your Company continued its past record of performance in recruiting a substantial number of new scientists and engineers who already are contributing to Company progress both in research and development, and in manufacturing and engineering.

To all of our employees, both new and old, we extend our appreciation for their efforts during a difficult year. We are confident that their efforts in 1977 will assure the Company of a rapid return to its usual pattern of growth.

As we write this report, we have many indications that the Company's future is bright. The backlog is at record levels; the production problem described earlier affected only last year's third quarter and is not likely to recur again in the foreseeable future; our U.S. Government markets are well funded presently and, to judge by next year's Defense budget, will be increased further; and our foreign markets show strong evidence of significant growth opportunities as we pursue new areas, such as South America and the Middle East. All in all, we believe it quite reasonable for you to expect the Company to resume and extend its historical rates of growth this year and next.

Dean A. Watkins

Chairman and Chief Executive Officer

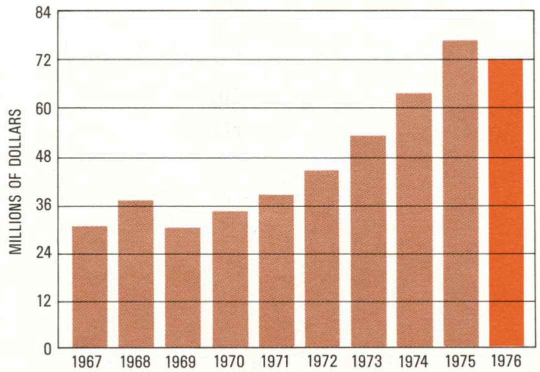
H R Johnson

President and Chief Operating Officer

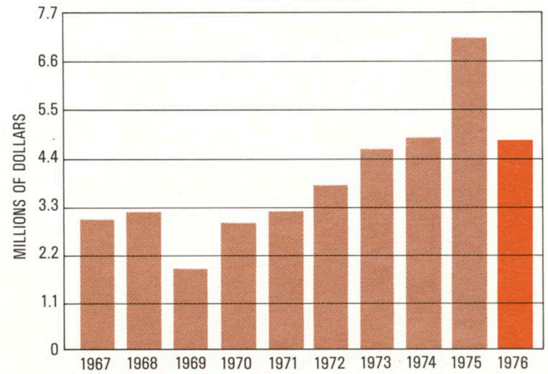
February 18, 1977

10 YEARS PERFORMANCE

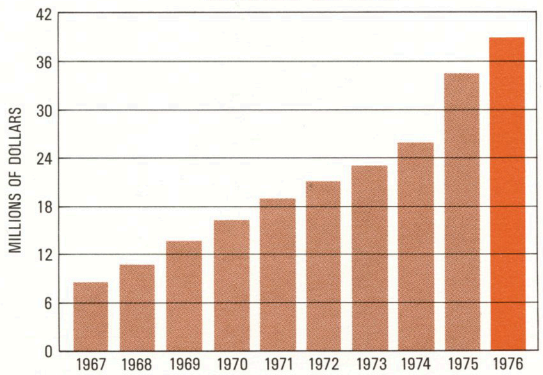
SALES



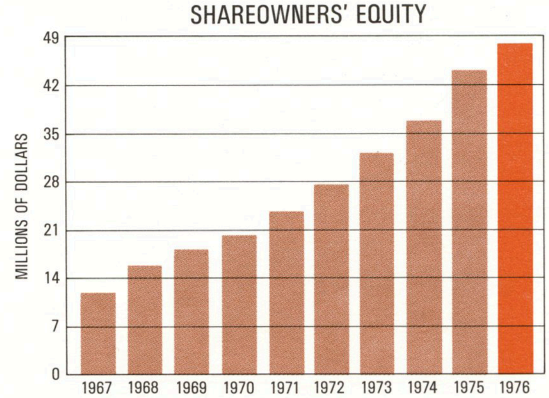
NET INCOME



WORKING CAPITAL



SHAREOWNERS' EQUITY



HIGHLIGHTS FROM PREVIOUS ANNUAL REPORTS

		1976	1975	1974	1973	1972	1971	1970	1969	1968	1967
OPERATING RESULTS	Sales	$71,982,000	$76,828,000	$63,630,000	$53,625,000	$45,181,000	$38,081,000	$34,444,000	$30,597,000	$37,160,000	$30,895,000
	Net Income	4,826,000	7,166,000	4,862,000	4,650,000	3,834,000	3,260,000	2,922,000	1,897,000	3,266,000	3,022,000
	Earnings Per Share	$1.57	$2.34	$1.60	$1.54	$1.27	$1.09	$.97	$.64	$1.12	$1.06
FINANCIAL POSITION	Working Capital	$38,779,000	$34,712,000	$25,968,000	$23,158,000	$21,019,000	$19,068,000	$16,247,000	$13,849,000	$10,725,000	$ 8,848,000
	Total Assets	61,694,000	57,727,000	47,018,000	40,538,000	33,978,000	29,710,000	25,584,000	22,106,000	21,727,000	19,146,000
	Shareowners' Equity	48,107,000	44,211,000	37,058,000	32,438,000	27,841,000	23,979,000	20,537,000	18,519,000	16,054,000	12,135,000
GENERAL STATISTICS	Average Number of Shares Outstanding	3,082,548	3,066,710	3,037,390	3,023,972	3,019,145	2,996,933	3,002,105	2,944,130	2,918,949	2,848,602
	Number of Employees at Year End	2,240	2,270	2,090	1,910	1,730	1,420	1,320	1,146	1,435	1,498
	Number of Shareowners at Year End	4,900	4,800	4,500	4,400	4,500	6,500	7,500	6,600	4,600	2,200

The figures shown above are taken from previous annual reports without subsequent adjustment of the years 1967 through 1969 for a pooling of interests occurring in 1970.

CONSOLIDATED BALANCE SHEET

ASSETS

	1976	1975
CURRENT ASSETS:		
Cash	$ 1,829,232	$ 1,649,455
Marketable securities	13,964,068	13,079,407
Receivables:		
Trade	15,196,659	14,127,321
Unbilled contracts	7,236,407	7,879,759
Inventories:		
Finished goods	591,173	275,724
Work in process	7,531,146	5,525,580
Raw materials and parts	2,447,330	2,282,492
Other	1,299,459	1,259,431
Total current assets	50,095,474	46,079,169
PROPERTY, PLANT AND EQUIPMENT:		
Land	131,834	529,695
Buildings and improvements	3,168,764	3,856,491
Machinery and equipment	14,830,649	12,699,075
Construction in progress	399,275	275,727
Total	18,530,522	17,360,988
Accumulated depreciation and amortization	(11,390,904)	(10,033,581)
Property, plant and equipment—net	7,139,618	7,327,407
OTHER ASSETS:		
Notes receivable	4,458,470	4,320,790
	$61,693,562	$57,727,366

LIABILITIES AND SHAREOWNERS' EQUITY

	1976	1975
CURRENT LIABILITIES:		
Accounts payable	$ 2,040,288	$ 2,427,248
Advances on contracts	1,338,332	
Income taxes	1,712,728	2,429,464
Other taxes	536,447	509,404
Payroll and profit sharing	4,143,019	4,523,639
Other	1,545,406	1,476,950
Total current liabilities	11,316,220	11,366,705
DEFERRED TAXES ON INCOME	2,270,000	2,150,000
SHAREOWNERS' EQUITY:		
Preferred stock, $1.00 par value—authorized and unissued, 500,000 shares		
Common stock, no par value—authorized, 15,000,000 shares; outstanding: 1976, 3,082,640 shares; 1975, 3,082,536 shares	3,229,611	3,229,507
Additional paid-in capital	3,574,726	3,518,102
Retained earnings	41,303,005	37,463,052
Total shareowners' equity	48,107,342	44,210,661
	$61,693,562	$57,727,366

See notes to consolidated

CONSOLIDATED STATEMENT OF INCOME

	1976	1975
Sales	$71,982,133	$76,827,879
Costs and expenses:		
Cost of goods sold	45,061,059	45,525,378
Selling and administrative	15,444,693	14,910,100
Research and development	4,381,080	3,971,856
Total	64,886,832	64,407,334
Income from operations	7,095,301	12,420,545
Other income:		
Interest and other income—net	659,419	644,236
Gain on real property	440,648	
Income before Federal and foreign income taxes	8,195,368	13,064,781
Federal and foreign income taxes	3,369,000	5,899,253
Net income	$ 4,826,368	$ 7,165,528
Net income per share	$1.57	$2.34

CONSOLIDATED STATEMENT OF SHAREOWNERS' EQUITY

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Shareowners' Equity
Balance, January 1, 1975	$3,188,153	$2,958,814	$30,911,230	$37,058,197
Net income for 1975			7,165,528	7,165,528
Cash dividends—$.20 per share			(613,706)	(613,706)
Sales under employee stock option plan—41,354 shares	41,354	559,288		600,642
Balance, December 31, 1975	3,229,507	3,518,102	37,463,052	44,210,661
Net income for 1976			4,826,368	4,826,368
Cash dividends—$.32 per share			(986,415)	(986,415)
Sales under employee stock option plan—104 shares	104	56,624		56,728
Balance, December 31, 1976	$3,229,611	$3,574,726	$41,303,005	$48,107,342

ed financial statements.

WATKINS-JOHNSON COMPANY AND SUBSIDIARIES

FOR THE YEARS ENDED DECEMBER 31, 1976 AND 1975

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	1976	1975
SOURCE OF FUNDS:		
Operations:		
Net income	$ 4,826,368	$ 7,165,528
Depreciation and amortization	1,822,157	1,554,999
Deferred taxes on income	120,000	825,000
Provided from operations	6,768,525	9,545,527
Sales of common stock to employees	56,728	600,642
Sale of real property, less related income	1,131,917	6,042,217
Other	12,949	17,961
Total	7,970,119	16,206,347
USE OF FUNDS:		
Additions to property, plant and equipment	2,779,234	6,495,842
Cash dividends	986,415	613,706
Notes receivable	137,680	135,115
Other		217,376
Total	3,903,329	7,462,039
INCREASE IN WORKING CAPITAL	$ 4,066,790	$ 8,744,308
Change in working capital consisted of:		
Increase (decrease) in current assets:		
Cash and marketable securities	$ 1,064,438	$ 8,327,529
Receivables	425,986	3,649,585
Inventories	2,485,853	(606,497)
Other	40,028	105,786
Total	4,016,305	11,476,403
Increase (decrease) in current liabilities:		
Accounts payable and accruals	(699,124)	1,493,115
Advances on contracts	1,338,332	
Taxes	(689,693)	1,238,980
Total	(50,485)	2,732,095
Increase in working capital	$ 4,066,790	$ 8,744,308

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation—The consolidated financial statements include those of the Company and its wholly owned subsidiaries after elimination of intercompany balances and transactions.

Translation of Foreign Currency Amounts—Foreign operations' account balances are translated using year-end exchange rates for current assets and liabilities, and the rate prevailing at time of acquisition for property, equipment, and related depreciation. Income and expense items, except for depreciation, are translated at weighted average rates of exchange prevailing during the year. Resulting exchange adjustments, which were not material, have been reflected in income.

Marketable Securities—Interest bearing investments are valued at cost and accrued interest which approximates market value.

Receivables—Unbilled contracts receivables are recorded when sales are recognized for long-term contracts under the percentage of completion method. Reductions in these receivables occur when invoices for products shipped or progress billings are rendered.

Receivables representing retainage and amounts expected to be collected after one year are not material.

Inventories—Inventories are stated at the lower of cost, using first-in, first-out and average cost basis, or market. Cost of inventory items is based on purchase and production cost; market is not in excess of net realizable value.

Property, Plant and Equipment—Property, plant and equipment are stated at cost. Provision for depreciation and amortization of buildings, machinery, equipment and leasehold improvements is primarily based on the sum-of-the-years-digits and declining-balance methods.

Sales Recognition on Long-Term Contracts—Sales are primarily recorded based on the percentage of completion method.

Income Taxes—The consolidated statement of income includes provisions for deferred income taxes for transactions that are reported in one period for financial statement purposes and in another period for income tax purposes. Deferred income taxes are provided on the earnings of the Domestic International Sales Corporation (DISC). Federal income tax expense is reduced by the investment tax credit allowed on property placed in service during the year. State and local income taxes, amounting to $693,000 for 1976 and $1,111,000 for 1975, are included in selling and administrative expenses.

Net Income Per Share—Net income per share is computed using the weighted average number of common shares outstanding during the year. The computation excludes outstanding stock options as their dilutive effect is not material.

2. LEASES

The Company's rent expense for property and equipment is as follows:

	1976	1975
Real Property		
Long-term leases	$2,190,000	$1,517,000
Other	153,000	313,000
Equipment	1,150,000	860,000
Total	$3,493,000	$2,690,000

The major portion of equipment rent originates from fixed monthly rental terms.

The Company is obligated to pay yearly, under long-term leases for real property, aggregate minimum rentals of approximately $1,725,000 through 1994, $1,142,000 through 1999, and $635,000 through 2005. The Company is also obligated to pay property taxes, insurance, maintenance and repairs on real property. These leases have terms which provide for lease extensions ranging from twenty-four to thirty-five years at revised rental terms, and some include options to purchase property at fair market value. In addition, the Company leases other real property for periods extending less than five years, having an aggregate annual rental of $137,000.

The present value of the above long-term leases totaled $16,600,000 at December 31, 1976 and $18,600,000 at December 31, 1975, determined by using a weighted average interest rate of 9% for both years, based on rates ranging from 6% to 10% in effect at the time of entering into the lease. If the long-term leases were treated as "capitalized property" and these property rights were amortized on a straight-line basis, with interest cost incurred on the outstanding lease liability, the approximate effect on 1976 net income would be a reduction of $257,000 and $159,000 in 1975.

Financing for a certain leased facility is provided by the Company. The noncurrent portion of the 7½% deed of trust note totaled $4,051,000 at December 31, 1976 and $4,121,000 at December 31, 1975, and is payable monthly through the year 1999.

3. SHAREOWNERS' EQUITY

The Employee Stock Option Plan provides for sale of common stock to certain key employees and officers. In November, 1976 the plan was terminated by the Board of Directors, however, commitments under previously issued grants remain in effect. The options previously granted, at market price on date of grant, are exercisable cumulatively as to one-third the number of shares in each of the third, fourth, and fifth succeeding years, and they expire at the fifth anniversary date. Replacement options granted contain more restrictive exercise features. Additional paid-in capital is increased for income tax benefits derived from early disposition of these shares by

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employees. A summary of stock option transactions follows:

	1976 Shares	1976 Price
Granted	18,350	$17.88 to $31.75
Terminated	7,100	
Outstanding at December 31	131,717	$12.25 to $34.88

	1975 Shares	1975 Price
Granted	14,250	$20.13 to $34.88
Terminated	8,506	
Outstanding at December 31	120,571	$11.63 to $34.88
Reserved for future grants at December 31	64,147	

In December, 1976 the Board of Directors approved, subject to shareowners' approval, the 1976 Stock Option Plan, reserving 300,000 shares for future grants to certain key employees and officers. Options to be granted under this plan contain stock appreciation rights under which provision the Company may pay any combination of cash or stock to the optionee for the appreciation on the stock since the date of grant. They are exercisable cumulatively as to one-third the number of shares in each of the third, fourth and fifth succeeding years, and they expire at the tenth anniversary date.

4. INCOME TAXES

The provision for Federal and foreign income taxes consists of the following:

	1976	1975
Current (less investment tax credit of $257,000 and $250,000)	$3,171,000	$5,229,000
Deferred		
DISC	120,000	825,000
Other	78,000	(155,000)
Total	$3,369,000	$5,899,000

The differences between the effective income tax rate and the statutory Federal income tax rate are as follows:

	1976	1975
Statutory Federal tax rate	48.0%	48.0%
Reductions in taxes due to:		
Investment tax credit	(3.1)	(1.9)
Tax-exempt and capital gain income	(3.3)	(.5)
Other	(.5)	(.4)
Effective income tax rate	41.1%	45.2%

5. CONTINGENT LIABILITIES AND COMMITMENTS

The major portion of the Company's sales is subject to the Renegotiation Act of 1951. Renegotiation has been completed for all years except 1975 and 1976. While there is no assurance that refunds will not be claimed by the United States Government for these years, the Company believes that profits realized on renegotiable sales are not excessive, and that refunds, if any, should not have a material effect on earnings.

Certain sales of the Company are subject to price revisions by appropriate Government agencies. Refunds, if any, which might arise from subsequent reviews are indeterminate and, in the opinion of management, no material refunds will be required.

In December, 1976 the Company exercised an option to acquire a thirty-five acre site in San Jose, California. In 1977, after the purchase of this property, the Company plans to start construction. The estimated cost of the site and building is approximately $9,000,000.

6. SALE OF REAL PROPERTY

In the fourth quarter of 1976 the Company terminated its lease on undeveloped property located in Cupertino, California for consideration of $540,000 from the lessor in the form of cash and a first deed of trust note on the property. Also in 1976 the plant located in Rockville, Maryland was sold for $1,100,000 and the gain from this sale was not significant. Net income from both of these transactions totaled $320,000 or ten cents per share.

7. QUARTERLY FINANCIAL DATA—UNAUDITED

Unaudited quarterly financial data for the year ended December 31, 1976, stated in thousands of dollars except per share amounts, is as follows:

	1976 Quarters 1st	2nd	3rd	4th
Sales	$17,292	$16,099	$17,938	$20,653
Gross profit	6,393	5,729	6,678	8,121
Net income	801	588	1,231	2,206
Net income per share	$.26	$.19	$.40	$.72

The fourth quarter includes gain on real property amounting to ten cents per share as discussed in Note 6.

AUDITORS' OPINION

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS

44 MONTGOMERY STREET
SAN FRANCISCO, CALIFORNIA 94104

The Shareowners and
Board of Directors of
Watkins-Johnson Company:

We have examined the consolidated balance sheet of Watkins-Johnson Company and subsidiaries as of December 31, 1976 and 1975 and the related consolidated statements of income, shareowners' equity, and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of the companies at December 31, 1976 and 1975 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Haskins & Sells

February 4, 1977

BUSINESS

Watkins-Johnson Company is a technologically oriented company engaged primarily in the design, development, manufacture, sale and service of advanced electronic systems and devices (components) for military, industrial and space applications. The Company's products are used by the reconnaissance, surveillance, intelligence, communications, telemetry, semiconductor, frequency measurement and testing markets.

CONSOLIDATED SUMMARY OF OPERATIONS

	1976	1975	1974	1973	1972
Sales	$71,982,000	$76,828,000	$63,630,000	$53,625,000	$45,181,000
Cost of Goods Sold	45,061,000	45,525,000	39,138,000	31,874,000	26,997,000
Selling and Administrative Expense	15,445,000	14,910,000	12,656,000	10,562,000	9,050,000
Research and Development Expense	4,381,000	3,972,000	3,638,000	3,344,000	2,341,000
Income from Operations	7,095,000	12,421,000	8,198,000	7,845,000	6,793,000
Other Income—Net	1,100,000*	644,000	600,000	622,000	308,000
Income before Federal and Foreign Income Taxes	8,195,000	13,065,000	8,798,000	8,467,000	7,101,000
Federal and Foreign Income Taxes	3,369,000	5,899,000	3,936,000	3,817,000	3,267,000
Net Income	4,826,000	7,166,000	4,862,000	4,650,000	3,834,000
Earnings Per Share	$1.57	$2.34	$1.60	$1.54	$1.27

*See Note 6 to consolidated financial statements.

SALES BY PRODUCT LINE

	1976	1975	1974	1973	1972
Systems	49%	54%	54%	52%	53%
Devices	51%	46%	46%	48%	47%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED SUMMARY OF OPERATIONS

1976 Compared to 1975

Sales decreased 6% in 1976 as a result of unexpected delays in receiving orders needed to meet sales objectives. Cost of goods sold decreased only 1% principally due to maintaining production capacity at normal levels and to a production problem affecting the third quarter. The selling and administrative expense increase of 4% reflects the continuation of these operations at previously planned levels. R&D expense increase of 10% was in accordance with projections. As a result of the above factors, income from operations in 1976 decreased significantly when compared with 1975. 1976 other income increased 71% principally due to sales of real property. The decrease in the effective federal tax rate in 1976 was a result of capital gain income and increased tax-exempt income.

1975 Compared to 1974

Sales increased 21% in 1975. The major increase came from greater demand for our products and some of the sales growth resulted from higher selling prices. Cost of goods sold increased only 16% primarily due to higher productivity. The 1975 gross margin was comparative to margins of periods prior to 1974. The selling and administrative expense increase of 18% was generally in line with the growth in sales. The R&D expense increase of 9% was lower than normal due to reduced spending as a percent of sales for this year. As a result of the above factors, income from operations in 1975 increased significantly over 1974; however, the 1975 profit margin was more in line with the Company's performance of previous years.

DIVIDENDS AND STOCK PRICES

1976		1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
Cash Dividends Paid		$.08	$.08	$.08	$.08
Stock Price	High	35⅝	30¾	30⅛	23⅞
(NYSE Close)	Low	25½	25⅝	15⅞	16⅞

1975		1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
Cash Dividends Paid		$.05	$.05	$.05	$.05
Stock Price	High	22¾	34⅞	38¼	30⅛
(NYSE Close)	Low	12⅛	19¼	24	23⅝

Shareowners desiring a copy of the Company's annual report on form 10-K may obtain one by writing to the Manager, Shareowner Relations, at the Company's address shown on the back cover of this report.

DIRECTORS

DR. DEAN A. WATKINS
Chairman

DR. H. RICHARD JOHNSON
President of the Company

DWIGHT M. COCHRAN
Personal Investments

DR. FREDERICK E. TERMAN
Vice President and Provost Emeritus, Stanford University

JOHN J. HARTMANN
Financial Consultant

NATHAN C. FINCH
Partner, Finch, Sauers, Player and King

DR. RITA R. CAMPBELL
Senior Fellow, Hoover Institution

JAMES A. COLLINS
Chairman, Collins Foods International

OFFICERS

DR. DEAN A. WATKINS
Chairman and Chief Executive Officer

DR. H. RICHARD JOHNSON
President and Chief Operating Officer

DR. O. THOMAS PURL
Vice President, Devices Group

BERNARD ROSEN
Vice President, Systems Group

BRUCE G. BLEECKER
Vice President

DR. WILLIAM E. KUNZ
Vice President

C. LOUISE BEER
Secretary

H. EDWARD BECKMEYER
Treasurer and Assistant Secretary

DONALD E. SCHAEFER
Controller

DUNCAN CURRY, III
Assistant Secretary

CARL L. AVELAR
Assistant Secretary

JOHN S. WILBURN, JR.
Assistant Secretary

GROUPS

Systems Group
Devices Group

SUBSIDIARIES

Watkins-Johnson International
Watkins-Johnson Italiana, S.p.A.
Watkins-Johnson Service Company

TRANSFER AGENTS/REGISTRARS

Wells Fargo Bank
Morgan Guaranty Trust Company

STOCK EXCHANGES

New York, Pacific, Boston and Philadelphia-Baltimore-Washington
Symbol: WJ

WATKINS-JOHNSON

Stanford Industrial Park
3333 Hillview Ave., Palo Alto, Ca. 94304